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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

LENSCRAFTERS, INC.; and EYEXAM OF CALIFORNIA, INC.,

Plaintiffs,

VS

LIBERTY MUTUAL FIRE INSURANCE COMPANY; EXECUTIVE RISK SPECIALTY INSURANCE COMPANY; UNITED STATES FIRE INSURANCE COMPANY; MARKEL AMERICAN INSURANCE COMPANY; and WESTCHESTER FIRE INSURANCE COMPANY,

Defendants.

CASE No. CV-07-2853 SBA

**REPLY IN SUPPORT OF MOTION TO
DISMISS LENS CRAFTERS' SECOND
AND THIRD CLAIMS FOR RELIEF**

Date: January 29, 2007

Time: 1:00 P.M.

Courtroom: 3

Judge: Hon. Saundra B. Armstrong

1 **I. INTRODUCTION**

2 Plaintiffs LensCrafters, Inc. and Eyexam of California, Inc. (hereinafter collectively
 3 "LensCrafters") ask this Court to recognize a cause of action that no other Court has previously
 4 recognized: a claim for bad faith failure to settle a *disputed* claim that is *still* in litigation. The
 5 California Supreme Court resolved this issue against LensCrafters in *Hamilton v. Maryland*
 6 *Casualty Co.*, 27 Cal.4th 718, 725 (2002), when it wrote that an insured's claim for breach of the
 7 duty to settle "does not mature, until a judgment in excess of the policy limits has been entered
 8 against the insured." LensCrafters ask the Court to rely on outdated, contrary and distinguishable
 9 authority to permit it to assert a failure to settle claim without a judgment in excess of applicable
 10 policy limits. California law does not support LensCrafters' claim in the context of this litigation
 11 and the underlying *Snow* litigation.

12 **II. THERE IS NO CLAIM FOR BAD FAITH FAILURE TO SETTLE A
 13 DISPUTED CLAIM THAT IS STILL IN LITIGATION.**

14 **A. A Claim for Breach of the Duty to Settle Does Not Mature
 15 Until There Has Been an Excess Judgment.**

16 There is no claim for breach of the duty to settle without a judgment in excess of the
 17 insurance policy's liability limits. LensCrafters insist that they can state a claim for breach of the
 18 duty to settle without pleading a judgment in excess of applicable policy limits, and rely
 19 extensively on dicta from *Camelot by the Bay Condominium Owners' Ass'n, Inc. v. Scottsdale*
 20 *Ins. Co.*, 27 Cal.App.4th 33 (1994) and *Larraburu Brothers, Inc. v. Royal Indemn. Co.*, 604 F.2d
 21 1208 (9th Cir. 1979).

22 Since the *Larraburu* and *Camelot* courts suggested appropriate parameters for a bad faith
 23 failure to settle claim, however, in 1979 and 1994, respectively, the California Supreme Court
 24 provided contrary, definitive instructions in *Hamilton v. Maryland Casualty Co.*, 27 Cal.4th 718,
 25 725 (2002). In *Hamilton*, a settlement was made in the underlying action with several defendants
 26 but without the participation of Maryland Casualty Company. Maryland's insured, VLP, joined
 27 that settlement agreement by stipulating to a judgment against it and assigning its breach of
 28 contract claims against Maryland to plaintiffs. *Hamilton*, 27 Cal.4th at 723. Explaining the
 parameters of a claim for breach of the duty to settle, the California Supreme Court wrote:

1 An insurer that breaches its duty of reasonable settlement is liable
 2 for all the insured's damages proximately caused by the breach,
 3 regardless of policy limits. Where the underlying action has
 4 proceeded to trial and a judgment in excess of the policy limits has
 5 been entered against the insured, the insurer is ordinarily liable to
 6 its insured for the entire amount of that judgment, excluding any
 7 punitive damages awarded. The insured's action for breach of the
 8 contractual duty to settle may be assigned to the claimant,
 9 regardless of whether assignments are permitted by the policy.
 10 Such an assignment may be made before trial, *but the assignment*
 11 *does not become operative, and the claimant's action against the*
 12 *insurer does not mature, until a judgment in excess of the policy*
 13 *limits has been entered against the insured.*

14 *Hamilton*, 27 Cal.4th at 725 (emphasis added). The California Supreme Court cited with approval
 15 the Court of Appeal decisions in *Safeco Ins. Co. v. Superior Court*, 71 Cal.App.4th 782, 788
 16 (1999) (“cause of action for bad faith refusal to settle arises only after a judgment has been
 17 rendered in excess of the policy limits”), and *Doser v. Middlesex Mutual Ins. Co.*, 101
 18 Cal.App.3d 883, 891-892 (1980) (settlement before any excess judgment issued cannot support
 19 claim for bad faith failure to settle). *Hamilton*, 27 Cal.4th at 726-728. On this basis, the
 20 California Supreme Court held plaintiffs' settlement could not support a claim for breach of the
 21 duty to settle. *Hamilton*, 27 Cal.4th at 734. None of the arguments presented by LensCrafters
 22 provide any principled reason to ignore this holding in *Hamilton*.

23 **B. Camelot and Larraburu Do Not Support LensCrafters Claim
 24 for Breach of the Duty to Settle.**

25 LensCrafters note that before *Hamilton* was decided, *Camelot* and *Larraburu* had both
 26 written that an excess judgment was not required to assert a claim for breach of the duty to settle.
 27 First, both courts wrote before the California Supreme Court's decision in *Hamilton*, and if
 28 writing those opinions today, both courts would be bound by *Hamilton*. *Aceves v. Allstate Ins.*
Co., 68 F.3d 1160, 1164 (9th Cir.) (“The district court, like us, is bound to follow the considered
 dicta as well as the holdings of the California Supreme Court when applying California law”).

29 Second, neither *Camelot* nor *Larraburu* permitted the claims LensCrafters ask this Court
 30 to permit. LensCrafters alleged that *Snow* was filed in 2002. (First Amended Complaint (“FAC”)
 ¶ 27.) LensCrafters litigated the allegations in *Snow* for several years, (FAC, ¶ 3), and reached a

1 settlement that is contingent upon approval and funding by the defendant insurers. (FAC, ¶ 34.)
 2 LensCrafters contend that regardless of whether a settlement is subsequently made without
 3 Markel's participation or any subsequent judgment, LensCrafters has a present claim against
 4 Markel for breach of its duty to settle. As detailed below, these allegations and LensCrafters'
 5 claim differ materially from the circumstances and claims addressed in *Camelot* and *Larraburu*.

6 Third, in both *Camelot* and *Larraburu*, the observation that an excess judgment was not
 7 necessary to assert a failure to settle claim was dictum. *Security Pacific Nat'l Bank v. Wozab*, 51
 8 Cal.3d 991, 1003 (1990) ("It is the general rule that the language of an opinion must be construed
 9 with reference to the facts presented by the case, and the positive authority of a decision is
 10 coextensive only with such facts"); *Krupnick v. Hartford Accident & Indemn. Co.*, 28 Cal.App.4th
 11 185, 199 (1994)(the holding of a case is the rule that constitutes the basis of the decision,
 12 determined by the statements of law necessary to the decision).

13 A brief review of the decisions in *Camelot* and *Larraburu* illustrates the limitations of
 14 both of these opinions in this action. *Camelot* found in favor of Scottsdale Insurance Company
 15 on the grounds that, although Scottsdale refused to accept a settlement offer, its decision did not
 16 breach a duty to settle.

17 We do not believe Scottsdale can reasonably be said to have run the risk of
 18 bad faith liability by refusing to settle the case for the amount demanded,
 19 where no danger of excess liability of the insured existed and where it was
 20 essentially undisputed that some of the defects at the property fell outside
 21 the scope of its policy. Where coverage up to the settlement demand is
 22 ultimately found, and an excess judgment is ultimately entered, the
 23 situation is far different from the case before us in which some of the
 24 defects were found not to be covered and there was never any threat of an
 25 excess judgment.

26 *Camelot*, 27 Cal.App.4th at 53. Although the *Camelot* court discussed whether an excess
 27 judgment was required to state a bad faith cause of action, Scottsdale did not assert that defense
 28 and the Court did not rely on that discussion to hold for or against Scottsdale. *Camelot*, 27
 Cal.App.4th at 49. *Camelot* did not hold that a failure to settle claim could be alleged without an
 excess judgment, but that is LensCrafters' claim in this action.

29 ///

1 *Larraburu* held that Royal Insurance Company's belated settlement, after a verdict in
 2 excess of policy limits allegedly damaged *Larraburu*'s business reputation, was sufficient to
 3 support a claim for bad faith failure to settle. *Larraburu* 604 F.2d at 1215. *Larraburu* complained
 4 that even after the jury issued a verdict in excess of the policy limits, Royal would not guarantee
 5 payment of any ultimate judgment in excess of the policy limits, and this allegedly caused
 6 *Larraburu*'s bankruptcy. *Larraburu* 604 F.2d at 1211.

7 Both *Larraburu* and Royal agreed that if the final judgment was within applicable policy
 8 limits, "there is no bad faith failure to settle, no tortious breach of duty, and no compensable
 9 damages; the earlier refusal to settle is not unreasonable, no matter how it appeared previously."
 10 *Larraburu* 604 F.2d at 1214. The *Larraburu* court was not willing to accept this proposition as a
 11 general rule, but declined to resolve the point because "an excess verdict was rendered."
 12 *Larraburu* 604 F.2d at 1214. Yet that proposition is exactly what LensCrafters asks this Court to
 13 find is the law of California, in part on the strength of *Larraburu*.¹

14 Even if they did provide authority to ignore the California Supreme Court's definitive
 15 instructions in *Hamilton*, neither *Camelot* nor *Larraburu* support LensCrafters' claim for breach
 16 of the duty to settle *Snow*.

17 **C. There is No Claim for Breach of the Duty to Settle a Disputed
 18 Claim That is Still in Litigation.**

19 LensCrafters contend there is other authority that does provide them with the right to
 20 assert their failure to settle claims in this action, based on their alleged damages other than
 21 coverage for a judgment in excess of policy limits. *Bodenhamer v. Superior Court*, 192
 22 Cal.App.3d 1472 (1987); *Barney v. Aetna Casualty & Surety Co.*, 185 Cal.App.3d 966 (1986). In
 23 *Barney*, however, the bad faith claim was not brought until after the insurer had settled the
 24 underlying action. Indeed, it was the settlement that allegedly barred the insured's cross-

25 ¹ It is also noteworthy that since *Larraburu* was decided in 1979, several California
 26 decisions have held, contrary to *Larraburu*, that an excess judgment is required to assert a failure
 27 to settle claim. *Hamilton*, 27 Cal.4th at 725; *RLI Ins. Co. v. CNA Casualty of California*, 141
 28 Cal.App.4th 75 (2006); *Wolkowitz v. Redland Ins. Co.*, 112 Cal.App.4th 154, 162 (2003); *Safeco*,
 71 Cal.App.4th at 788; *Finkelstein v. 20th Century Ins. Co.*, 11 Cal.App.4th 926, 929-930 (1992);
Doser, 101 Cal.App.3d at 891-892.

1 complaint, which led to the insured's bad faith claim. *Barney*, 185 Cal.App.3d at 970-971. In
 2 *Bodenhamer* the insurer's counsel advised the insurer the insured's liability in the underlying
 3 actions was reasonably clear, and most of those claims had been paid. *Bodenhamer*, 192
 4 Cal.App.3d at 1475. In neither case did the underlying action involve a disputed claim that was
 5 still in litigation. This difference between *Barney*, *Bodenhamer* and this action is controlling.

6 Thus, before the California Supreme Court's decision in *Hamilton*, a prominent treatise on
 7 California Insurance Litigation explained that "(a)bsent an excess judgment, there can be no bad
 8 faith action based on excess liability. [However] [t]he insurer's refusal to settle may be
 9 actionable on some other basis." *J.B. Aguerre, Inc. v. American Guarantee & Liability Ins. Co.*,
 10 59 Cal.App.4th 6, 13 (1997)(quoting Croskey et al., California Practice Guide: Insurance
 11 Litigation (The Rutter Group 1997) ¶ 12:575, rev. #1, 1996). After the California Supreme
 12 Court's decision in *Hamilton*, that same treatise offered a revised explanation: "Under the
 13 circumstances noted below, the insured may have a bad faith action against the insurer even
 14 though the insurer has settled or paid such claims." (Croskey et al., California Practice Guide:
 15 Insurance Litigation (The Rutter Group 1997) ¶ 12:571, 2007.) *Hamilton* makes clear that a
 16 failure to settle claim depends upon an excess judgment; since *Hamilton* the Hon. H. Walter
 17 Croskey recognized that while an insurer's settlement may permit other claims regarding
 18 allegedly improper settlement practices, there is no claim for failure to settle a disputed claim that
 19 is still in litigation.

20 LensCrafters ask the Court to ignore *Hamilton*, and adopt a rule that might have been the
 21 law in California, had the California Supreme Court chosen to follow the suggestions of *Camelot*
 22 and *Larraburu*, rather than the holdings of *Safeco*, *Finkelstein* and *Doser*. That is not the law of
 23 California today, however, and LensCrafters cannot support their failure to settle claims without
 24 an excess judgment, by instead alleging that they are suffering other damages because of the
 25 continued litigation of *Snow*.

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1 **D. Ohio Law Also Requires an Excess Judgment to Assert a**
 2 **Claim for Breach of the Duty to Settle.**

3 Ohio law also requires the insured suffer an excess judgment to assert a claim for bad faith
 4 failure to settle. *Calich v. Allstate Ins. Co.*, 2004 Ohio 1619; 2004 Ohio App. LEXIS 1439
 5 (2004), *appeal denied*, 103 Ohio St.3d 1409, 812 N.E.2d 1290; *Romstadt v. Allstate Ins. Co.*, 59
 6 F.3d 608, 615 (6th Cir. 1995). *Accord, D.H. Overmyer Telecasting Co., Inc. v. American Home*
 7 *Assurance Co.*, 29 Ohio App.3d 31, 502 N.E.2d 694 (1986)(“before an injured person can
 8 maintain an action against the tortfeasor’s insurer, the insured person must obtain a judgment
 9 against the insured”); *Chitlik v. Allstate Ins. Co.*, 34 Ohio App.2d 193, 198 (settlement does not
 10 provide injured party right to assert claim against insurer).

11 LensCrafters correctly notes that Markel does not contend that the laws of Ohio and
 12 California conflict. Markel’s reliance on Ohio law was a protective argument, made in the event
 13 LensCrafters argued and the Court agreed that, unlike Ohio law, California law did not require an
 14 excess judgment to assert a failure to settle claim.

15 LensCrafters contend that Ohio law only requires an excess judgment when there is the
 16 possibility of collusion between the insured and plaintiff in the underlying action. LensCrafters
 17 makes too much of that argument. While that possibility is one reason for the rule, it is not the
 18 only reason, and there is no authority for LensCrafters’ suggestion that absent collusion, an
 19 excess judgment is not required. On this point California and Ohio law are in agreement: there is
 20 no failure to settle claim without an excess judgment.

21 **III. LENSCRAFTERS’ CLAIM FOR UNSPECIFIC DAMAGES CANNOT**
 22 **SAVE ITS FAILURE TO SETTLE CLAIM.**

23 LensCrafters contends that they are entitled to any consequential damages caused by
 24 Markel’s failure to fund the proposed settlement in *Snow*, and that they are not obligated to
 25 specify those damages in its complaint, (but it does explains that it has incurred defense costs to
 26 defend *Snow* and will continue to incur those expenses if compelled to continue to litigate *Snow*.
 27 Ergo, LensCrafters reasons, they have a present claim against Markel to recover those damages,
 28 even if no further damages materialize.

1 First, LensCrafters' argument is premised on their contention that an excess judgment is
 2 only required to establish damages from breach of the duty to settle, and not as a condition for a
 3 failure to settle claim. That contention is erroneous, for the reasons discussed in Section II.

4 Second, LensCrafters' argument would swallow the rule, even to the extent that rule is
 5 recognized by LensCrafters, because there is no litigation in which the parties are not burdened in
 6 some fashion and put to some expense. Under this standard, in *every* case in which an insurer
 7 fails to accept a settlement offer deemed reasonable by the insured, there is a claim for breach of
 8 the duty to settle that can be asserted immediately, without an excess judgment. Under this
 9 standard, therefore, *Hamilton*, *RLI*, *Wolkowitz*, *Safeco*, *Finkelstein* and *Doser* are not merely
 10 distinguishable from LensCrafters' claim, but they were wrongly decided. Every plaintiff in each
 11 of those actions should have been permitted to recover, at the very least, the defense costs they
 12 incurred settling the underlying actions, without the participation of the insurers.

13 Finally, because there is an inherent burden to defending litigation, even *Larraburu*
 14 recognized the financial hardship and mental anguish inevitably suffered because of continued
 15 litigation is nonetheless not considered when evaluating a settlement offer. *Larraburu*, 604 F.2d
 16 at 1215 n.6. Thus, none of the cases LensCrafters' cite approved the inherent "cost" of litigation
 17 as an element of damages caused by an insurer's failure to accept an allegedly reasonable
 18 settlement offer. *Larraburu*, 604 F.2d at 1211 (failure to accept reasonable settlement offer
 19 allegedly caused Larraburu's bankruptcy); *RLI*, 141 Cal.App.4th at 79 (no claim for failure to
 20 settle despite subsequent settlement, after another year of litigation, for an additional \$1 million,
 21 absent a judgment in excess of policy limits)(judgment on pleadings affirmed); *Wolkowitz*, 112
 22 Cal.App.4th at 158 n.5 (no claim for failure to settle without "excess judgment," despite insured's
 23 subsequent bankruptcy and expectation that settlement would support bad faith claim)(demurrer
 24 sustained); *J.B. Aguerre, Inc. v. American Guarantee and Liability Ins. Co.*, 59 Cal.App.4th 6, 11-
 25 12 (1997)(no claim for bad faith coercion of insured to contribute to settlement, although insured
 26 retained personal counsel in addition to defense counsel retained by insurer). Although *Hamilton*,
 27 *Safeco*, *Finkelstein* and *Doser* were decided on motions for summary judgment or after trial, *RLI*,
 28 *Wolkowitz* and *Aguerre* were decided on the pleadings. LensCrafters is not entitled to plead

1 unspecified damages allegedly caused by the continued litigation of *Snow* and then establish their
 2 claim after discovery. *Hamilton, Safeco, Finkelstein, Doser, RLI, Wolkowitz* and *J.B. Aguerre* all
 3 included circumstances in which the insured incurred at least some litigation expenses because of
 4 the insurer's refusal to accept an allegedly reasonable settlement offer, but none of those
 5 decisions permitted plaintiffs to assert the failure to settle claim LensCrafters seeks to assert in
 6 this action.

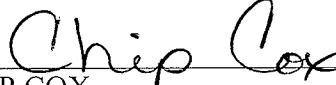
7 **IV. CONCLUSION**

8 LensCrafters has made a creative effort to avoid the definitive rule stated in *Hamilton*: an
 9 insured's claim for breach of the duty to settle "does not mature, until a judgment in excess of the
 10 policy limits has been entered against the insured." LensCrafters does not offer the Court any
 11 basis to establish a new rule under California law, and its failure to settle claims should be
 12 dismissed. For these reasons, Markel respectfully asks the Court grant its motion to
 13 dismiss the second and third claims for relief in LensCrafters' First Amended Complaint.

14 Dated: January 15, 2008

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15 By


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 18 MARKEL AMERICAN
 19 INSURANCE COMPANY

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 21 DOCS:S6560-012\544002.V1

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